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Twin Disc, Inc.

First Quarter 2016 Financial Results Conference Call

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CORPORATE PARTICIPANTS

John Batten, *Chief Executive Officer, President, and Chief Operating Officer*

Jeff Knutson, *Vice President - Finance, Chief Financial Officer, Treasurer, and Secretary*

Stanley Berger, *Moderator, SM Berger*

CONFERENCE CALL PARTICIPANTS

Walter Liptak, *Seaport Global*

Josh Chan, *Baird*

Rand Gesing, *Neuberger*

Ryan Curdy, *Pacific Ridge*

PRESENTATION

Operator:

Good day, everyone, and welcome to the Twin Disc Inc. First Quarter 2016 Financial Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Stan Berger of SM Berger. Please go ahead, sir.

Stanley Berger:

Thank you, Anthony. On behalf of the Management of Twin Disc, we are extremely pleased that you have taken the time to participate in our call, and thank you for joining us to discuss the Company's fiscal 2016—I'm sorry, first quarter results and business outlook.

Before I introduce Management, I would like to remind everyone that certain statements made during the course of this conference call, especially those which states Management's intentions, hopes, beliefs, expectations, or predictions for the future, are forward-looking statements. It is important to remember that the Company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in the Company's annual report or Form 10-K, copies of which may be obtained by contacting either the Company or the SEC.

By now, you should have received a copy of the news release which was issued this morning before the market opened. If you have not received a copy, please call Annette Mianecki at 262-638-4000, and she will send a copy to you.

Hosting the call today are John Batten, Twin Disc Chief Executive Officer, President, and Chief Operating Officer; and Jeff Knutson, the Company's Vice President of Finance, Chief Financial Officer, Treasurer, and Secretary. At this time, I will turn the call over to John. John?

John Batten:

Thank you, Stan, and good morning, everyone. Welcome to our fiscal 2016 first quarter conference call. As usual, we will begin with a short summary statement, and then Jeff and I will be happy to take your questions.

Looking at the first quarter results, sales for the 2016 fiscal first quarter were $37.4 million versus $64.8 million a year ago, a decrease of about 42%. You may recall from our last call we had a number of customers moving up shipments in advance of our July and August shutdown. Our largest plant here in Racine was shut down for the entire month of July due to a very light demand. Many of the orders pulled up were to ship throughout the quarter, not just in July. This movement in orders coupled with the sharp decrease in demand in new orders and extended shutdown help explain the significant difference in sales levels.

Looking at the end product market, the North American oil and gas market and the Asian oil and gas and marine market had by far the worst comparable year-over-year. This is the first quarter in over a decade that there were no forward market sales into the global pressure-pumping market. New oil and gas aftermarket activity also saw significant reductions versus last year and previous quarters.

Looking at the Asian end market, the Chinese domestic oil and gas sector experienced a sharp, sudden pullback as activity slowed and inventory grew. The slowdown in the Chinese economy also significantly impacted the regional marine market, both offshore oil and gas vessels and tug and coal barge activity in Indonesia.

Sales into our other marine markets and industrial markets were down about 25% compared to last year and the previous quarter. Sales into our transmission markets declined versus fiscal 2015 first quarter levels by about 75%. This fall-off is directly attributed to the extreme low levels of oil and gas shipments. Gross margins for the quarter were 21.9%, compared to 34.5% a year ago and 29% the previous quarter. The comparatively poor mix due to the extremely low level of oil and gas shipments and the increased shutdown at a North American production facility were the primary drivers in the gross margin decline.

First quarter spending in Marketing, Engineering, and Administrative, or ME&A expenses, decreased by 670,000 versus the same period last year from $15.9 million to $15.2 million, which was our lowest first quarter ME&A spending since Fiscal 2011.

As we mentioned in the press release, the year-over-year reduction was due to cost containment, currency fluctuation, and reduced bonus expenses, but were offset by increases in stock compensation, pension expenses, and corporation development activity.

During the quarter, we sold our assets and the distribution rights to Twin Disc products in the southeast territory of the United States for approximately $4.1 million, which resulted in a net gain of $500,000. I will come back to this sale later in the call.

The net loss for the quarter was $4.3 million, or $0.39 per share, compared to net earnings of $4 million, or $0.36 per share, a year ago.

Looking at the balance sheet, we ended the quarter with total debt of $14.3 million, up $500,000 from the end of the prior fiscal year, and cash of $23 million, which was flat from the prior quarter, and an end result and a net cash position of $8.7 million. Mindful of the lower revenue levels, we are working to keep our working capital in line with these lower levels. Inventories are 21% lower than year-ago levels and down 4% from the prior quarter. In the quarter, our working capital reduced 13% from $112.8 million to $97.5 million. These reduction activities will continue for the foreseeable future.

Our six-month backlog increased from $34.4 million to $37.5 million. While we are pleased to see the increase, we remain cautious and can attribute part of the increase to the prolonged shutdowns during the quarter. General market conditions remain very weak with just a few pockets of relative strength, such as the European marine market; the North American industrial market, especially aftermarket activity; and the global ARF (phon) market.

Turning back to the sale of our distribution entity for the moment, we have worked over the last few years to keep our balance sheet in position to make a key strategic acquisition or to weather a sudden and steep downturn, but not both at the same time. It is becoming ever more clear that the return of North American oil and gas is increasingly unpredictable and unlikely to happen in the next few quarters. As a Company, we have to be profitable, assuming oil and gas forward market sales are zero. This will force us to make hard capital allocation decisions like the sale of Twin Disc Southeast. In selling the distribution entity to one of our independent North American distribution partners, we can use this capital for increased product development and other growth initiatives.

Our global footprint, especially the manufacturing footprint, is the result of growth investments in markets like the European pleasure craft market and the global oil and gas markets that are under extreme pressure. Until this quarter, we have had the volume in other product markets in addition to a certain minimum in oil and gas to maintain acceptable margins.

In addition to the $6 million of cost reductions announced in the fiscal 2015 fourth quarter, we have identified another $4 million of annualized savings across the Company that will be implemented in the second quarter. Looking specifically at our manufacturing entities, we are targeting a 15% reduction in our cost structure through a variety of actions, which will be rolled out over the next few quarters.

Given the uncertainty in many of our traditional markets, the reliance on Asia and other emerging markets for growth and the ability of macroeconomic forces like OPEC to have such an impact on key markets like oil and gas, management recognizes that we need to simplify and to reduce the complexity of the Company if we are to be profitable without a forward market oil and gas component, but to remain capable delivering when that demand returns.

Turning quickly to the outlook, on the last call we talked about how the first two fiscal quarters of 2016 would be our most challenging. This has only become more apparent as we saw orders pushed out during late August and September. Thankfully, the trend has become somewhat better in October, but it is still too early to tell if this is a blip or a real inflection point. This doesn't change our short-term plan to address our cost structure for the new reality of $50 oil.

That concludes my prepared remarks, and now Jeff and I will be happy to take your questions. Anthony, please open the line for questions.

Operator:

Thank you. Today's question-and-answer session will be conducted electronically. If you'd like to ask a question at this time, please press star, one on your touchtone telephone. If you are using a speakerphone, please turn your speaker function off to allow your signal to reach our equipment. Once again, that is star, one if you have a question over the phone at this time. We'll pause for just a moment to give everyone a chance to signal.

It appears our first question comes from Walter Liptak with Seaport Global.

Walter Liptak:

Hi, thanks. Good morning, guys.

John Batten:

Good morning, Walter.

Walter Liptak:

I wanted to ask—I wanted to ask about the oil and gas markets, and I guess it's completely understandable that there'd be no pressure-pumping sales in the quarter, but wonder if we can maybe get two data points from you. One, what are you hearing from your salespeople, and what are they hearing from customers regarding when their excess inventory of equipment will be—will be consumed? And then, I wonder if you'd comment on parts sales during the quarter.

John Batten:

First, let's see. I think if there's going to be any return to forward market activity, I believe for us anyway it'll happen in China first, just because they don't have the dollars and the unit excess inventory that's here in North America and certainly as a percentage of the fleet, there's not the same level of excess. So, I could see forward market units to Asia continue—resuming in the next couple of quarters. That's not out of the realm of possibility at all. North America is just another conundrum.

I would have said that a year ago we were at the point where, by and large, all of the excess capacity had been consumed, and we saw that with new orders. Now, with the level of operators in distress, and by and large, of the fleets that we're in, those operators I don't think are the ones who are much distressed, but they do have excess capacity. Now, that's coupled with the ones who are in distress and there is a lot of excess capacity. I've read probably the same things you have, that that could be anywhere from, again, 25-40%, which puts us back in North America where we were a couple of years ago with a lot of excess inventory.

The difficult part, Walt, and the hard—the one that's hard to predict is how will that excess capacity find its way into the hands of the people who are not in duress and could use it? That's the million-dollar question, and we just don't know. Is that two quarters? Is that a year? And so, that's why we remain cautious, that—we think our stuff—our stuff is being used, so there is an aftermarket component, but when are new units going to come in North America? I think it's going to be very specific and very targeted. They'll replace a spread here or a spread there, or we'll get to do a retrofit, but I just don't know the answer to that, Walt, and—I think we're—at a minimum, this is another year to two years of North America shaking out the excess inventory.

Then, with respect to—you asked about aftermarket. The aftermarket components, the rebuilds dropped significantly. It didn't go to zero, but my guess is two-thirds, 50% to two-thirds of what we were doing a year ago to this past quarter.

Walter Liptak:

Okay. Given that it may take a year or two with that sort of an outlook, I guess kind of getting to the cost-cutting aspect of it, what kind of timing can we think about for getting to that break-even level, either this year or next year? Then maybe what—and then if that's too difficult to address, maybe what kind of revenue level overall are you at break-even?

John Batten:

Okay. Those are all good questions. What we are looking at and what we're addressing starting this quarter and really through the remainder of the fiscal year is we're going to assume forward market oil and gas is zero, and we are going to organize ourselves so that we are profitable at that level. Will we be able to get to that run rate by the end of the fiscal year? That I don't know, but it is—that is where we're headed.

Certainly, if there's an oil and gas component, our break-even level is much more attractive if there isn't, but just—the margins on that are higher. It's been one year—one pause of about two-and-a-half years of real strong forward market activity in North America, but we had the Asian component, which was certainly enough to keep us with good margins and profitable. Now, with the Asian component going on and off overlapping North America, it's just not a very comfortable picture. So, we're going to position ourselves that we can be profitable without oil and gas forward markets. So, it's going to take a few quarters, Walt, to do that, but we'll get there.

Walter Liptak:

Okay. Okay, good. Good luck with that. It's obviously a major undertaking. I wanted to also ask a question about the sale of the distribution asset.

John Batten:

Yes.

Walter Liptak:

What started the strategy for selling distribution? Maybe thoughts around how—how much more do we have to go. How much money can you raise as you exit that?

John Batten:

Well, it wasn't—part of it was done to maintain a clean balance sheet, but it was also done—it's just when are we going to—our strategy on how we allocate capital and what we use our capital, and then it's—I wouldn't necessarily jump to conclusions that we are under a strategy to sell all distribution entities. That's not the case. But, if we can find a partner within the Twin Disc family that can do the job that we were doing, or I would add, probably do it better because in certain areas they'll have more product lines, and they can make—actually make that entity stronger, it seems best for Twin Disc and the products if someone else handles the sales in that territory, and we take that capital and we either can invest in reducing our cost structure, new product development and engineering here at the plant, or we can go out and buy a product line that we can then spread throughout the entire Twin Disc organization.

We'd actually embarked on this transaction before the dramatic turndown in the first quarter, but in the middle of the first quarter, it became very apparent that that was in fact a good decision, that we can use that cash, use that capital, and then invest it in other places, knowing that the Twin Disc product in that territory will be taken care of as well or better than what we were doing. So, it is a strategy. It's recognizing what is our core competency? What can we do here with Twin Disc management for our customers? Should we be investing that $4 million in the distribution of the southeast territory of the United States, or should we be investing in new product for the global Twin Disc family?

Walter Liptak:

Okay. So, should we look at the southeast asset sales as like a one-off, or should we expect that there's going to be more from quarter to quarter?

John Batten:

I would say that we are taking—take the assumption that we're taking, that we have no oil and gas forward market. It forces you to make difficult decisions about capital allocation, and I wouldn't—it's distribution businesses, it is manufacturing subsidiaries, it is product lines, so—we said that there are a lot of options on the table to realign our cost structure, and this decision was just one step, along with the mid-Atlantic region, which was a much smaller territory that we did last fiscal year.

Walter Liptak:

Okay. Okay, great. Thanks. I'll get back in queue.

John Batten:

Thanks, Walt.

Operator:

Our next question comes from Josh Chan with Baird.

Josh Chan:

Hi. Good morning, John and Jeff.

Jeff Knutson:

Hi.

John Batten:

Morning, Josh.

Josh Chan:

Hi. If you can just go around to your different end markets, certainly it was a tough quarter, but I was curious to hear how the markets compare versus kind of your expectations coming into the quarter.

John Batten:

Yes. I guess overall—say, 42% down. I would say by and large that we'd expect it to come down, if we were at $65 million roughly a year ago, that our expectations, given the plant closures, were probably more in line with being at 50. So this was, again, double what we had anticipated being down, and really, really driven by one area with the effect on one plant, and it was—we knew that North America oil and gas was going to be down. The aftermarket component surprised us a bit, but we were surprised at how quickly things turned off in China, really kind of in late August into September. So, that wasn't anticipated;

China oil and gas going to zero, the marine activity in the region slowing down so significantly. So, that really was the surprise that I guess that—taking us from 65 to 50, we'd figured that that was going to happen, but going from 50 to 35 really was the unexpected severity in China.

Josh Chan:

Okay. Then the somewhat of a rebound, I don't know if you want to call it a rebound in October, but improvement, I guess, was that in China as well, or were you seeing slightly better trends in October versus those two months?

John Batten:

Actually, I would say so far the blip has been mostly North America that's been driving—I take that back, and holding steady in Europe, but kind of the improvement over what we saw at the end of the first quarter to the beginning of the second quarter really I would say is really driven by North America, and not—but not oil and gas.

Josh Chan:

All right. All right, and then on the gross margin line, is there a way to ballpark how much impact that production shutdown affected the quarter? I guess asked another way, what would normal gross margin have been like at the lower demand level excluding the shutdown?

Jeff Knutson:

Hey, Josh. Assuming that same volume without that shutdown, the gross profit would have been lower. The percentage would have even been lower. So, really what you have to do, I guess, is model what sales would have been in the quarter if we hadn't announced the shutdown. It would have been marginally higher. I think there's probably a few million related to under-absorption at the facilities that was driven that we weren't able to recover from the shutdown, but it still would have been a very, very difficult quarter.

Josh Chan:

Right. Okay. Then on the cost savings, you announced a $4 million cost savings initiative, and you also talked about 15% manufacturing cost reduction. Should we look at those as different programs? Are they related somehow?

John Batten:

They are related. I would say of the $4 million, about—slightly more than half of that is—would be cost-of-goods-sold-related.

Josh Chan:

Okay, okay. That makes sense. Is there a way for ME&A expenses to come down beyond the portion that's attributable from the $4 million? How should we think about that line relative to—as revenue comes down potentially?

Jeff Knutson:

That's a good question. Obviously there are a lot of sort of fixed costs in that layer, and that's what we're trying to attack as we look at our structure around the world. I think, as John pointed out, it was a relatively low quarter for ME&A compared to our previous several years. It was the lowest quarter since the first quarter of fiscal '11.

That being said, we know that that's an area that we need to try to drive some cost savings in, and that's what we'll be looking at over the next weeks and quarter.

Josh Chan:

My last question's on sort of John's comments about capital allocation. Am I reading it right that with the proceeds that you're receiving, John, from the sales of distribution or whatever else that you might do, you're looking at new product development organically to try to accelerate growth or—

John Batten:

Yes. Both, Josh. I would not take off the table corporate development activities, acquisition, whether it's product lines, a company, or internal product development.

Josh Chan:

Okay. So, it could be a combination of all of those?

John Batten:

Yes, it could be a combination of all of those, but realistically, as I mentioned, we've been maintaining the balance sheet the way we have to get that key strategic acquisition or to weather a downturn. But certainly right now, with the severity of the downturn, the primary focus is on the existing business at hand and making that profitable, but we do not want to lose sight of growth initiatives, whether it's, again, organic product line or company.

Josh Chan:

Great. Understood. Thanks so much for your time.

John Batten:

Thanks, Josh.

Operator:

Our next question comes from Rand Gesing with Neuberger.

Rand Gesing:

Hey, guys.

John Batten:

Hey, Rand.

Jeff Knutson:

Hello, Rand.

Rand Gesing:

Can you give us a sense for fort of what's left as it relates to distribution?

John Batten:

Sure. We have Mill-Log Equipment, which is in the Pacific Northwest of the United States, so that would be Oregon, Washington, and then it also extended into the Canada with British Columbia, Alberta, and Manitoba. Then we own our distribution facility for Australia, and we have our master distributor in Singapore, which handles all of our Asian dealers. Then our Company Twin Disc SRL is our distributor for Italy. So, those would be the distribution companies that are left.

Rand Gesing:

Okay. So, those who are trying to think about just in terms of revenue flow-through, have you sort of sold maybe almost half of your distribution by these two pieces?

John Batten:

No, I would—on a sales level, it'd probably be—boy, not even 10%.

Rand Gesing:

Really?

John Batten:

Maybe 10%. Between five and 10%, yes.

Rand Gesing:

Okay, okay, okay.

John Batten:

The entities that remain are significantly larger in revenue than the Twin Disc Southeast or the territory that was above them.

Rand Gesing:

Okay. What I guess I'm sort of backing into a little is sort of piggy bank there. What's in the piggy bank? I mean in terms of proceeds you could potentially do, obviously you're not going to do all of them because you're not going to get the good partner fit, but is there anything we should think about in that math of what you've done, $5 million versus—obviously it's not going to be—I'm not going to get exact numbers, obviously. I'm not trying to, but I'm just trying to understand a little bit about if you do transact a couple of these, what could sort of be monetized. I guess what I'm asking is is the southeast business—is there something incredibly attractive about that or profitable that it would have made that slug of revenues much higher multiple to you guys than—

John Batten:

No. I would say that there were a couple—again, we embarked on this activity last fiscal year when we were having a great year, so this wasn't a distress move, so to say. But when we're looking at it, the territory of the southeast United States for us was—it was the least profitable of the distribution entities. Typically what happens is—we acquired this territory over 20 years ago before I started with the Company. So, it was 20 years ago, and over time this distribution entity had migrated to just the Twin Disc product line, so our industrial products and our marine products, and didn't have a whole lot of other lines.

Typically what happens—what can happen, not necessarily—but what can happen is if we own a distribution territory, the other lines, the other companies that are represented , for whatever reason, maybe we don't focus on them as much or they pull up that line because they think that we're competitors, so you end up doubling down on cyclicality.

In the southeast territory of the United States, it had been very heavily pleasure craft — obviously Florida; the Georgia territory — so it became more challenging for us. Great Lakes Power Products, the company that acquired it has a lot more lines that they can bring to the territory and help fund the activity there, and they're right next door to us, so it was an adjacent territory. It made sense. They can leverage their costs and their management systems.

It really just seemed—in all honesty, when we started out, it's "how do we better serve the customers and our products in the territory? Who can do it better than we can? Because we're struggling with this, and we don't want to invest more time and more capital in it. How do we invest less time/less capital and do a better job?" Then it became obvious that we turn to one of our neighboring partners. So, that's how it came about. The timing was pretty good, actually, to have it conclude in the first quarter because it was nice to get that capital back and keep it dry for something else that we think will benefit the entire Twin Disc family, not just the customers in the southeast territory.

Rand Gesing:

Right. Okay, okay. I think it makes sense. I think it makes good sense. Just what you—I wasn't following you quickly enough. In your prepared remarks, you said something and then you laid out Euro marine, North America industrial, and global ARF. I wasn't sure whether you were seeing some transition there or what you were—what point you were trying to make?

John Batten:

The comments on those markets were the ones that had the best comparables to a year ago, so hadn't fallen off at 25%, and there's just a few pockets that really didn't—pretty much everywhere we looked, this year versus last year, the comparisons were negative. The exceptions were the European marine market. Sounds counterintuitive, but comparatively that did well, aftermarket for North America industrial was okay, and then the ARF market. But anywhere else you look, it was not nearly as good comparisons.

Rand Gesing:

Okay. What do you sort of feel, to the degree that you have any sense, Asian non-oil and gas, you know, the work boats and things of that nature, is that—given the sort of negative news we're hearing of deceleration in China, should we sort of feel like that market's going to be sort of soft for you guys over the near term?

John Batten:

I think it'll be at least a quarter or two. Again, I'm confident that that activity will recover somewhat by the end of the fiscal year. There's just a lot of activity in this—it's a lot of wins and losses, but we will get out there, and through the remainder of the year, get more wins than losses. But no, it was a—Rand, I can't tell you, it was a sharp contraction in the middle of the—well, towards the end of the first quarter.

Rand Gesing:

Right. Okay. I guess my last question is it sounds like you guys are pretty well along in terms of things you're thinking about doing and leverage you're thinking about pulling to bring the cost structure down, but it sounds pretty dramatic to me, and I'm just wondering how sure are you that you're not going to cut into some bone here, or are you willing to do that? Because that's pretty draconian to say, "Hey, one of the key markets that we had, high margin oil and gas, we can't rely on in the plan, and so we're going to size the business for that." Just your comments there would be helpful.

John Batten:

Sure. I didn't mean it to sound draconian, but we have to accelerate some of the decisions we were considering making just given going from at the peak of oil and gas in 2012 $350 million down to 265.

Now, currency plays a big impact on—the 265 last year was much better than the 265 the year before, but the numbers of units—they're still utilizing the temporary layoffs in Europe, (inaudible). The recognition that the marine markets is part pleasure craft aren't going to return to peak levels; some of our plans have been able to transition and serve patrol boat and commercial markets. Others haven't been successful with their product lines, so it—Rand, it's not draconian. They're just logical decisions given that you can't—we can't rely on—we were able to rely on since 2011 a base business of—if we assume fiscal '12 was 100% oil and gas, that was like the maximum. We had been quite happy with that 20% to 25% level, if that's what Asia was going to give us, than the lower level of North America, but now we have to be prepared that we could go multiple quarters with it actually being 0%. Then we do have—that takes us to—that takes us from an acceptable absorption level to an unacceptable absorption level. So again, and your comment on cutting to the bone, I certainly don't want to make decisions that when oil and gas comes back we are unequipped to react, because that will be—that would be a truly unacceptable result. That's why we're not announcing everything now or rushing into it. We want to make very informed decisions on how we want to be positioned in the future, but we have to be less complex, because just the volume in oil and gas and the margin is not there to cover up necessarily any inefficiencies with—number of facilities and $350 million and the cost structure is one thing. If you're staying now at $200 million, we can't afford that same cost structure.

Rand Gesing:

Right. Okay, great. Appreciate it. Look forward to seeing you soon. Bye.

John Batten:

Thanks Rand.

Operator:

Just as a reminder, please press star, one if you have a question at this time. It appears we have a follow-up question from Walter Liptak with Seaport Global.

Walter Liptak:

Yes, based on the last questions, I started thinking about what the revenue run rate might be for the next quarter. I know you don't give guidance, but I just mean directionally. Your backlog's at $37 million. You saw your order trends in the quarter. Are you thinking that next quarter's going to be flat from where you were this quarter, or is it—can it be down (inaudible)?

John Batten:

Walt, it'll be a better quarter. Sales will be up, just because it won't be—fewer shutdown days, so more shipping days. The mix as far as the product—we're still assuming zero oil and gas, so it's going to make it difficult that way, but I think you'll see higher shipment levels. I don't expect it'll be a—will it be enough to get us to break even? Unless we can cram a lot more oil and gas in the end as far as aftermarket, I don't think so, but historically we don't have an oil and gas component.

We're going back to the historical quarterly performance of Twin Disc, although not at a loss. I wouldn't say that. But the first quarter's by far the worst quarter of the year, second quarter's better, third quarter's better, fourth quarter's better. It basically kind of tracks the number of shipping days throughout the year in each quarter, the number of shipping days in each quarter, and just the seasonality of low order activity in the summer.

I see that trend now continuing where each successive quarter of the year will be better. Where do we cross the break-even point? Is it the second quarter or one of the second half quarters? I'll be honest, Walt, I don't want to make any promises, but it will be difficult to do in the second quarter, just given that we'll be taking some—that we're at—we're taking cost production activities kind of in the middle of the quarter.

Walter Liptak:

Okay. All right, great. Good luck, guys.

John Batten:

Thanks, Walt.

Jeff Knutson:

Thanks.

Operator:

Our next question comes from Ryan Curdy from Pacific Ridge.

Ryan Curdy:

Hi, good morning. Earlier you mentioned expectations of reducing networking capital. Can you just kind of walk us through that, what your cap ex plans are? Also, I think the last call you guided to $10 million for the year. Your balance sheet's already pretty light compared to where it was, say, five years ago in the last downturn. Just kind of what your thoughts are in terms of cash flow for the year.

Jeff Knutson:

Yes. We're looking at, obviously, working capital in terms of inventory, driving that down, but at the same time, as John said, being prepared for a recovery in oil and gas. That's the component that we're very mindful of that we need to be ready and be poised for that recovery.

Cap ex, you're right. Historically we're in the $8 to $11 million range. I think we're very good at being flexible in identifying those key components that we need to spend on, and possibly delaying some of the discretionary spending as we work through a difficult period. I think we would probably estimate today between $5 to $8 million in cap ex, primarily some maintenance type items and some high payback machine tools.

Ryan Curdy:

Got it. Thank you.

Operator:

It appears we have no further questions in the queue at this time.

John Batten:

All right. Thanks, Anthony. Thank you for joining our conference call today. We appreciate your continuing interest in Twin Disc and hope that we have answered all of your questions. If not, please feel free to call Jeff or myself. We look forward to speaking with you again in January following the close of our fiscal 2016 second quarter.

Anthony, I'll now turn the call back to you.

Operator:

That does conclude today's conference. Thank you for your participation.